



**DEFERRED COMPENSATION**  
**AD-HOC INVESTMENT SUBCOMMITTEE**

**MINUTES**

**Tuesday, April 1, 2008**

The Deferred Compensation Ad-Hoc Investment Sub-Committee meeting was called to order at 9:10 a.m. on Tuesday, April 1, 2008, City Hall, Wing, W-260

**Roll Call**

Donna Busse  
Julia Cooper  
Conrad Taylor

Management Employees' Representative  
City Manager's Representative  
Police Representative

**Also Present**

Suzanne Hutchins  
Jeanne Groen  
Cheryl Boston  
Bill Tugaw  
Chuck Sklader  
Gary Bozin  
Peter Belardinelli  
Lisa Gilarde  
Bruce DeMers

Attorney  
Human Resources, Deferred Compensation Secretary  
Human Resources, Deferred Compensation Staff  
Consultant, SST Benefits  
Consultant, SST Benefits  
ING  
ING  
ING  
Retiree

**9:00 – 11:00 A.M.**

**April 1, 2008**

**City Hall, Wing W260**

**NEW BUSINESS**

Bill Tugaw indicated that the copy of the Investment Policy Statement dated April 27, 2006 was the actual approved Investment Policy and not the draft as indicated on the agenda. Bill Tugaw provided the proposed changes to the Investment Policy staff to copy prior to the meeting. As staff was preparing copies of the draft investment policy at this time, it was recommended that the Investment Subcommittee move to item 2 on the agenda. Prior to Item 2, introductions of all attendees of the meeting including: Bruce DeMers, Jeanne Groen, Conrad Taylor, Donna Busse, Julia Cooper; from ING, Peter Belardinelli, Gary Bozin, Lisa Guillard; and from SST Benefits Consulting, Chuck Sklader and Bill Tugaw.

**1. Review and discuss revised draft Investment Policy and Procedures Statement**

This item was deferred with a request for a special meeting to be coordinated with the next regular Deferred Compensation Advisory Committee Meeting on April 22, 2008.

**2. Review 2007 Year-end ING investment results - Gary Bozin & Peter Belardinelli, ING –**

ING provided attendees with a binder for the City of San Jose Deferred Compensation Plan Annual Investment Review Period Ending 12/31/07. Lisa Guillard presented the ING "scorecard" with all of the investments currently offered under the 457 Deferred Compensation Plan. This scorecard is a nine factor

*NOTE: If you have any questions or concerns, please contact Cheryl Boston at (408) 975-1465*

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model. The nine factors are grouped into 5 categories. ING calculates the scorecard on a semi-annual basis, at year-end and mid-year. The scores as of this report are year-end 2007.

Funds are reviewed on a ten year history. They do not score funds less than 3 years because the numbers would not be statistically valid. Each fund's rating is compared to its peer group. The 5 categories are weighted:

- 30% is return; ING looks at 1 year, 3year, 5year, and 10 year returns and look at the 24 month rolling quarterly returns as well at the rolling alpha to understand manager consistency.
- 20% is risk; ING looks at the standard deviation and upside/downside capture ratio.
- 20% is risk adjusted return; represented by the Sharpe ratio and ratio of return to standard deviation.
- 20% is consistency of style
- 10% is expense vs peers.

When a fund falls below a score of 4 it goes on ING's watch list for performance reasons. Funds also go on ING's watch list for non-performance reasons such as manager change, firm issues, style change.

ING identified James Small Cap Fund as scoring 4.9 grading "fair" and Templeton Global Smaller Companies Fund – Class A scoring 5.9 grading "Peer Average" as nearly, but not now, being on the watch list. She also noted that Oppenheimer Main Street Opportunity Fund – Class Y and Wanger U.S. Smaller Companies is rated as "excellent" primarily because of the ten (10) year rating methodology and the excellent performance of over five (5) years ago.

ING prepared a two page report for each fund that details all of the calculations behind the final score. The exhibit behind the final tab in the binder contains a more summarized version of the calculations for each of the funds in the portfolio. Lisa provided a detailed report on the James fund to Jeanne.

3. Review SST Benefits Consulting 4<sup>th</sup> Quarter - 2007 City of San José Deferred Compensation Plan Report - Bill Tugaw & Chuck Sklader, RIA

Chuck Sklader reviewed SST Consultants report for City of San José's Deferred Compensation Plan. Mr. Sklader provided an overview of the Stock Market, the economy, and the City of San José's 457 Deferred Compensation's Plan performance against a customized benchmark. Fourth quarter comparison of the City's mutual fund portfolio against indexes was a negative -1.8. Overall, the Consultants feel City of San José has a strong portfolio; although, there are some recommendations, including funds being placed on the Watch List.

In the fourth quarter, \$1.5 million moved from the fixed account to other funds, particularly asset allocation funds. SST analyzed the Stabilizer Fund. As of the end of the year the difference between the book value, which is the accumulated total of all participants assets in fixed account, and the market value of underlying investments that support the book value; there was a difference of \$5 million. SST would like these amounts to be closer; and at some point in time this may even reverse with the market value exceeding the book value. For now through January that number dropped about 50%. A characteristic that has impacted the market value is underperformance by the investment manager at ING. ING has an RFP out for a different Investment Manager. SST considers January a trend, not a stand alone successful month in reducing the difference between book and market value.

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Bill Tugaw referenced the two other finalist in the RFP were heavily weighted with mortgage backed holdings in their fixed accounts and it was one of the reasons ING was selected. Mr. Sklader indicated that one of the finalists had 95% in mortgage backed securities. City of San José portfolio has 30.8% in mortgage backed securities with SST Consulting finds very acceptable and is lower than the index which had 38.6%. Of the mortgage backed securities in the City of San José portfolio, approximately 2.7% was sub-prime loans resulted in a 15% reduction in value in that portion of the portfolio.

Mutual Funds in the portfolio were evaluated based on the three year Sharpe Ratio, because it measures risk and performance. It is considerably higher through December 31, 2007 than the customized benchmark. Standard deviation is higher than the benchmark, mainly due to Oppenheimer Developing Markets.

Mr. Sklader highlighted sections in the report including key mutual funds and specific funds that were put on the Watch List, and recommend no action be taken at this time: Oppenheimer Main St Opportunity, Wanger US Smaller Companies, James Small Cap, Oppenheimer Developing Markets, and Templeton Global Smaller Company. These funds did not meet the criteria outlines in the Investment Policy. Member Busse asked what percentages of stocks in the Templeton Global Smaller Company fund were in non-US stocks. 21% of assets were in US and 79% were in non-US.

Member Busse requested a universe comparison chart from SST Consultants of our plan compared to other plans at the next committee meeting.

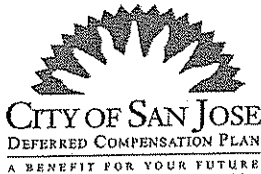
SST Consulting recommends replacing the Fidelity VIP Contrafund, the annuity version of the retail fund, and mapping existing assets of the City of San José assets in the fund and new deferrals to the Fidelity NewInsights I fund. The Fidelity VIP Contrafund fees for the City of San José for the Fidelity VIP Contrafund are .66 basis points. The recommendation is based on a change of investment managers and management concept. Lisa Gilarde confirmed that ING could add Fidelity NewInsights I fund to the portfolio prior to the 60 days Investment Policy transition requirement to allow participants to voluntarily move their funds and re-allocate their contribution. ING will draft education letter to participants to be available for committee's review at April meeting per Investment Policy and Procedures, page 16.

Mr. Sklader briefly explained a report covering one, three, and five year fund returns; fund performance against peer groups according to Morningstar; and Best Fit Index comparison as required by the Investment Policy, and reports related to the City of San José Deferred Compensation Portfolio including: statistics, asset allocation, expenses, and participation.

Member Cooper suggested a recommendation summary be provided to the full Committee that clarifies the funds have been placed on the Watch List however they are not significantly underperforming and participants can draw their own conclusions and be aware that the Subcommittee and Committee are doing their due diligence, observing the issues with respect to their fiduciary responsibilities and following the Investment Policy and any decision to replace the funds would require action at a later time based on future performance. Mr. Tugaw indicated the Executive Summary was intended to provide that information. There are needed corrections to the Executive Summary.

Member Cooper requested SST provide the Annual Investment Review report to the full Committee, with revisions to Watch List page and make a brief presentation explaining the investment policy for placing five funds on Watch List and rationale for the recommendation for no action at this time

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during the April 24, 2008 full Committee Meeting. Mr. Tugaw will send a soft copy of the corrected Watch List information by Friday April 4, 2008

M.S.C. (Busse/Cooper) to add the following as an agenda item on the April 24, 2008 full Committee Meeting that the Committee consider requesting a one, three, and five year rate of return sheet with peer comparison be provided by consultants on a quarterly basis.

M.S.C. (Cooper/Busse) for Investment Subcommittee to recommend to the full Committee for the replacement of Fidelity VIP Contrafund with the Fidelity NewInsights I fund at the April 24, 2008 meeting.

M.S.C. (Cooper/Busse) recommend that the full Committee approve placing these five funds on the Watch List and this item it to be placed on the agenda for the April 24, 2008 meeting.  
that SST provide the Annual Investment Review report, with revisions to Watch List page, to the full Committee and make a brief presentation explaining the place five funds on Watch List for the April Meeting.

M.S.C. (Cooper/Busse) to schedule a Special Meeting to revisit Item 1 of the agenda, Review and discuss revised draft Investment Policy and Procedures Statement.

#### PUBLIC COMMENTS

#### ADJOURNMENT

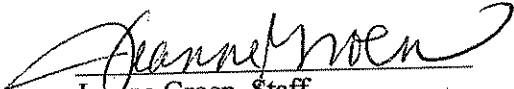
Donna Busse  
Investment Subcommittee Member

Julia Cooper  
Investment Subcommittee Member

Conrad Taylor  
Investment Subcommittee Member



ATTEST:

  
Jeanne Groen, Staff  
Deferred Compensation

NOTE: M.S.C. MEANS MOTION SECONDED AND CARRIED, UNLESS OTHERWISE INDICATED, MOTION PASSED UNANIMOUSLY.